



**Director of
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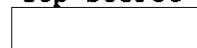
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Special Analysis

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JAPAN: New Cabinet

Prime Minister Nakasone has selected a cabinet that gives him latitude for policy innovation and that should help restore party unity. [redacted]

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Comment: //In a conciliatory gesture to those in his party who opposed him, Nakasone named Shintaro Abe, an opponent in the party primary, as Foreign Minister. The appointment of Abe, who was Minister of Trade and Industry in the last cabinet under Prime Minister Suzuki, ensures continuity on US-Japanese trade problems and should help reduce the feuding between the two ministries.//

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//Sadanori Yamanaka, a champion of agricultural interests, is the new Minister of Trade and Industry.

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//The Defense Agency went to Kazuo Tanikawa, a Komoto faction member known for his support of the Japan Peace Corps. Nakasone recognizes that his defense policy will receive close scrutiny by the press and by the opposition in parliament because of his well-publicized hawkish views, and he chose a minister who is unlikely to cause much additional controversy.//

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//The Tanaka and Suzuki factions were rewarded for their support in the party election with additional cabinet posts, while the Fukuda and Komoto factions lost portfolios. Masaharu Gotoda, from the Tanaka faction, was appointed Chief Cabinet Secretary, the Prime Minister's righthand man. At the same time, Nakasone emphasized party unity by continuing the existing factional balance in the top party posts.//

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IRAQ-IRAN: Khark Unaffected by Attacks on Shipping

Additional information on the attacks by Iraq last weekend on shipping along the Iranian coast indicates that--despite Iraqi claims--tankers at Khark Island were not damaged, although at least three vessels elsewhere were hit. An Iranian tanker that was reportedly attacked some distance north of Khark Island and an Iranian barracks ship--the former Italian luxury liner *Rafaello*--that was hit near Bushehr both were heavily damaged, according to Lloyd's of London. An Indian bulk carrier also was struck by rockets near Bushehr but reportedly sailed on to Dubayy. [REDACTED]

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Comment: The airstrikes probably were made by attack helicopters and jets, some using Exocet missiles. These recent incidents and Iraqi threats to attack ships trading at Khark have not hampered operations there. Spot oil prices, charter rates, and war-risk insurance rates have not been affected. [REDACTED]

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ISRAEL: Reaction to Warning

Prime Minister Begin is consulting with his advisers on possible responses to warnings on Wednesday by the board investigating the Beirut massacre that senior political, military, and intelligence officials may be "harmed" by the inquiry's findings. [REDACTED]

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Comment: Begin probably believes that his government can survive findings that some of its members acted improperly so long as no evidence of direct Israeli involvement is uncovered. Thus far there is no evidence of concern among Begin's coalition partners, and the opposition Labor Party apparently has decided to wait until the board completes its inquiry before reacting. The Prime Minister will be watching closely for signs of uneasiness in the religious parties, his key coalition partners. If either the National Religious Party or Agudat Israel appears unhappy because of the inquiry findings, Begin will probably urge them to support new elections. [REDACTED]

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NORWAY: Funds Approved for INF Infrastructure

Prime Minister Willoch's Conservative government has narrowly secured passage of the 1983 defense budget, including funds for Norway's contribution to the INF infrastructure. The opposition Labor Party, which sought to delay a decision on INF funds, used the parliamentary debate this week to attack Defense Minister Sjaastad's procedural handling of the INF issue. The issue caused the most serious parliamentary split on defense matters since World War II. [REDACTED]

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Comment: The Labor Party still officially endorses the NATO position on INF arms control and deployment but does not want to appear to be putting pressure on Belgium and the Netherlands, which are scheduled to base INF missiles but have not yet taken a firm decision. These two countries in fact are proceeding discreetly with their INF deployment preparations, and neither anticipates major problems in securing infrastructure contributions in its legislature. The Danish Government shares the Norwegian opposition's concern and has been trying to hold off its infrastructure decision, but Copenhagen may now feel it needs to move ahead. [REDACTED]

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IRELAND: Election Results

//Incomplete returns indicate that Prime Minister Haughey's Fianna Fail will remain Ireland's largest party, but the opposition Fine Gael and Labor parties together will have 86 seats, which would be enough to form a small majority in the 166-member Dail.//

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Comment: //Haughey and Fine Gael leader FitzGerald both will seek support from Labor and other small parties before the reconvening of the Dail in mid-December. Many Labor deputies have misgivings about the austerity and social policies FitzGerald has said he would follow, and he may have to make some concessions to secure Labor support for a coalition or a minority government. Unless Haughey can engineer a deal with other parties--an unlikely prospect--he is likely to be ousted as Fianna Fail leader.//

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Special Analysis

MEXICO: Challenges for de la Madrid

When President-elect de la Madrid takes office next week, he will have to deal with the unstable financial and economic situation. The limited alternatives available to restore financial stability are politically hazardous, with risks heightened by the disenchantment, anger, and frustration prevailing among Mexicans.

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The country's depleted foreign exchange reserves, \$10 billion in deferred debt payments, and continuing capital flight will require austerity and sacrifice for an extended period. De la Madrid's background prepares him to tackle the technical aspects of the crisis, but he has yet to show the ability to inspire the Mexican people with the sense of national purpose essential for a successful economic program.

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De la Madrid has been in control of the ruling party since early this year. His position has been strengthened by President Lopez Portillo's tentative accord with the IMF signed earlier this month, and he appears confident that he will be able to undertake needed economic reforms with the support of the public. The President-elect apparently believes that the record voter turnout in July demonstrates continuing support for the ruling party-government complex, in spite of widespread disillusionment with the government's economic policies.

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The strongest pressures on the new president will come from labor unions affiliated with the ruling party. Dissidents from outside the party--especially if opposition leftists become more radical--also will test the government's ability to incorporate disaffected elements and avoid resorting to repression.

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Austerity and Economic Decline

De la Madrid is determined to cooperate with the IMF and probably will adjust economic policies sufficiently to gain IMF support for a stabilization program.

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The public, however, will regard the belt-tightening as punishment by Mexico's creditors and will find austerity especially difficult to accept following the prosperity of the recent oil boom. [REDACTED]

The economy will contract. If Mexico manages to meet quarterly IMF targets, reschedules payments of principal, and borrows another \$5 billion in international markets, the GDP probably will still fall 2 percent next year. [REDACTED]

As austerity takes hold, imports and industrial production will decline. Falling consumption and mounting bankruptcies and unemployment could provoke social unrest, including strikes and violent demonstrations. [REDACTED]

Reactions From Unions and Bankers

Enforcing the required austerity measures is likely to become increasingly difficult. Influential interest groups--including labor, business, and the middle class--will try to protect their incomes. [REDACTED]

De la Madrid probably will be able to continue IMF-mandated interest and exchange policies, in part because of the inability of the private sector to bring direct pressure on the government. Holding the line on wages and subsidies will be harder, however, because organized labor is the largest and best organized source of support for the ruling party. [REDACTED]

If de la Madrid is unable to develop the domestic political backing needed to maintain IMF support, Mexico's economic decline is likely to accelerate. Economic activity could be reduced by as much as 10 percent. [REDACTED]

Without an IMF stabilization program, many bankers probably would reduce the risk of bad debts by cutting existing trade credit lines and calling in debt obligations. If Mexico could not pay, some foreign bankers would begin to foreclose on loans and seize Mexican assets. To avoid chaos in the world financial system, however, major international bankers would try to hold small banks in line and arrange another short-term debt repayment moratorium. [REDACTED]

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